

Operator:

Good morning, ladies and gentlemen. Welcome to Hypera Pharma's earnings call for the 1Q24. We have Mr. Breno Oliveira, CEO; and Mr. Adalmario Couto, IRO, with us today.

This is being recorded. The video can be accessed at www.ri.hypera.com.br.

We would like to inform you that all participants will be in a listen-only mode. We will then have a Q&A session. Further instructions will be given at this time.

Before proceeding, I take this opportunity to reinforce that some information in this conference call may contain projections or statements about future expectations. Such information is subject to known and unknown risks and uncertainties that may cause such expectations not to materialize or be substantially different from what was expected.

I will now turn it over to Mr. Breno Oliveira. Mr. Oliveira, you have the floor.

Breno Oliveira:

Good morning. Welcome to our 1Q24 earnings call. I would like to start by talking about growth on slide 3. Net revenue was up by 8% reaching R\$1.8 billion, in line with 1Q expectations. Net revenue growth was driven mostly by recent growth of our retail sell-out as a result of good performance in Skincare, Prescription Products and Similar products, cardiology, gynecology, respiratory system, pain and nausea stand out.

Sell-out was up by 7% in the quarter. The retail market was 9%. That performance is driven mostly by slower growth in categories related to Flu, respiratory, pain and Fever that play an important role in our revenue than the rest of the pharmaceutical industry. That was a 3% decrease on average, grew by 2% in 1Q24.

The growth in other category, which combines most of our new pipeline, was about 10% once again driven by chronic treatment and preventive treatment medications. Net revenue growth and our discipline on expenses management contributed to increase our EBITDA by 10%, net income by 17% and our cash generation in almost 60%. Adalmario will be giving you further details on our financial performance.

We keep on substantially investing research and development, innovation and on the expansion of our production capacity. We have maintained the compensation of our shareholders.

Aiming at strengthening our product portfolio. We have introduced line extension in Skincare and Consumer Health in the quarter, new vitamins, new respiratory system drugs and women's health. Still on the quarter, interest on owned capital was R\$185 million, R\$0.29 per share. We have also introduced our Governance and Sustainability Committee. Its goal is to strengthen corporate governance and support our Board of Directors in defining ESG guidelines.

I will turn it over to Adalmario for further results or further details on the results of the quarter.

Adalmario Couto:

Good morning, Breno. Good morning, everyone. Let me address the highlights of the quarter. This is on slide 4. Net revenue was over R\$1.8 billion. Growth was in line with our sell-out level. That's again our commitment to maintain healthy inventory levels with our customers.

Let me point out the importance of the new introductions. The past 2 years, these new launches accounted for most of the net revenue for the quarter, products that were launched in the past 5 years which is our innovation index contributed to almost R\$400 million for the net revenue in this period.

Gross margin was at 61%, down almost 3 percentage points considering the idleness of the plant given the rearrangement of the collective vacations for the employees with more revenue from the Non-Retail channels, derma products, cosmetics and similar ones. However, we had more dilution in more marketing and G&A lines.

We have become more efficient in media expenses, focusing investments on digital media, which ensures more visibility to the entire portfolio of brands. We have a reduction on the production of free samples, but it should go back to normal levels in the 2Q. Most of the expenses dilution more than offset the pressure on gross margins. EBITDA margins was above 35%, therefore.

Net income was R\$391 million, up by 15% when compared year-on-year as more operational profitability comes in as well as in the 23% reduction in financial expenses with lower indebtedness level and almost a 2.5 percentage points drop in the debt cost for the quarter.

On to slide 5 now. We have our cash flow. R\$479 million was cash flow from operations, 60% above year-on-year. That's the record high for the Company in the 1Q. The main driver there was the almost R\$230 million reduction in the inventory. That's the result of our strategy to bring our inventory levels down in finished products and raw material.

Working capital investment was not only smaller because of the increase of receivables in the quarter. We had higher concentration of sales in the end of the quarter and the slowing down of the sell-out in later 2023. Operational cash flow was up and contributed to help the Company invest more significantly in innovation and in CAPEX.

Free cash flow generation was R\$319 million compared to R\$93 million in 1Q23, and this lower CAPEX level for the quarter was a one-off event, given the dephasing of some of the expansion projects that might be resumed later this year. We had a positive financial cash flow of R\$330 million because of the new debenture liquidation of R\$600 million.

We keep on monitoring the credit market, and with the latest improvements in the marketplace, we have room to perform our liability management strategy, aiming at extending the debt profile and, at the same time, reduce costs. By doing so, our net debt was R\$7.4 billion in the quarter, or 2.5x the expected EBITDA for the year.

Now I will turn it back to Breno Oliveira for his final remarks.

Breno Oliveira:

Thank you, Adalmario. We have seen a normalization of the pharmaceutical market growth. According to our expectations, and as we had said in our previous earnings call, 1Q growth was associated with an expressive operational cash generation, a record high for the quarter, and it contributed substantially with more free cash flow for the Company.

Our top priority in the year is to grow sustainably, expanding our market share in the top categories through the pipeline of new products and our leading brands, not jeopardizing the profitability of our business according to the guidance for 2024.

We see an enormous opportunity to grow our operational cash flow to a much higher standard to that of the operational results, especially because of the expected inventory reduction for 2024.

Thank you once again for attending, and let's move on to the Q&A session.

Joseph Giordano, JPMorgan:

Good morning. Let me ask you about the innovation level. It's about 21%. It used to be close to 30%. I know you have had some acquisitions that would get in the way. So my question is, when do you expect to see a greater contribution from this innovation rate and the revenue line?

My second question, I do not know whether you can quantify it easily, when you look at gross margins, when you had the collective vacation last year, how much deleveraging from the plants? Can you quantify that? And what is the mix effect?

And my last question is about the revenue dynamics. When you take the last 12 months, it's somewhat lower. When should it go back to normal levels, do you believe? Thank you.

Breno Oliveira:

Joe, I will answer the first one, and then I will turn it over to Adalmario. As to innovation rate and major variation, this may vary from quarter to quarter. But just like you said, after the acquisitions you have this new revenue from the portfolio of Takeda, Sanofi and Buscopan. This is coming down a little. But if you were to exclude that revenue, the innovation rate maintains or it remains at 30%.

Again, it varies from quarter to quarter. So the quarter is to bring it back to those historical levels. So we keep on investing on innovation, especially on the capitalized portion of it. And I mean, the development of new products that are not part of the Company's portfolio yet. There are variations depending on the quarter. So the goal for the year is to maintain that same level and growing in line with what we did last year.

Adalmario Couto:

Joe, let me address the second question about the gross margin. I believe that the expected gross margin for the year is a little less than what we had last year, especially because of the product mix and the production rhythm for the year because we are reducing our finished goods inventory levels. In 3Q, you may recall that we had a higher

level of finished products because we had some slowdown in the market towards the end of the year.

But this quarter, things are back to normal, and we expect a gross margin a little below that of last year. We expect that for this year. We had a lower impact because of the idle times in the plants. It affected production costs, CGSs, free sample production. But when you take into account the 1H of the year when compared to last year, it would be lower, a little bit.

And there are price judgments. And now, starting in April, we had a price increase that should bring some positive impact in margins for 2Q. I do not know whether I answered your question or not.

Joseph Giordano:

Yes, you did. What about receivables? Should we pay attention to it, or is it more the effect out of the base?

Adalmario Couto:

Receivables are at the higher range level. The Company's strategy is to maintain a healthy level of inventory in our consumers, about 110, 120 days. In the quarter, it was a little higher, but mostly due to the higher concentration of sales towards the end of this 1Q and the slowdown we had in sell-out back in November, and even stronger in December. It's a basic cause, but the strategy of the Company remains the same. We will maintain that range between 110 and 120 days.

Gustavo Miele, Goldman Sachs:

Good morning. Thank you for the presentation. I have two questions. Number one, it's about medical visitation expenses. That was one of the highlights for the quarter. We would like to understand more qualitatively what is the limit for the dilution of that line in the following quarters, and not representing risks on sales? The ramp-up of prescription drugs, this is going well, that relationship with doctors is key in this vertical. Can we expect a similar level for the medical visitation lines further down the road not jeopardizing revenue? Could you please elaborate on that?

My second question is more objective. Let me go back to working capital. Let me address the suppliers' topic. Are there any seasonal volatilities, something related to mix that may justify this reduction in days like we have seen at recent quarters? Or is it something more specific? Anything related to the relationship with the top suppliers that may explain this more constrained limits?

Breno Oliveira:

Gustavo, I will address the first question and then Adalmario will answer the second one. As to medical visitation, I think I did not make that very clear in the release. But what we have here, we have promotions and others. It has to do with conventions we have with our representatives. These are internal conferences and with other sales personnel.

And expenses were down. Our convention was a lot smaller. Just the managers, not everyone, not every representative. They were attending it online so expenses were down. We had about R\$15 million that accounts for most of the difference. On top of

what Adalmario said, free samples also follow within the same line. But that was the top driver for the quarter.

Just last year, we had an increased team of medical visitation that was in the middle of the year last year. And we have no plans whatsoever reducing the teams or distributing free samples throughout the year. This is something very specific that fell within the same line within other. That explains R\$15 million that would have contributed to marketing expenses growth. And on this slide here, that would be even more so.

Adalmario Couto:

Gustavo, let me answer the second question. I think the main driver for the constrained payment terms was reducing our raw material inventories. When you take, for example, the API suppliers, they can give us more or longer payment terms.

We have been reducing new purchases, and it's only natural that it would impact the average days of the payment terms. And other suppliers with smaller or shorter payment terms, we keep on purchasing normally. There's a minor reduction because of the mix but this effect is minute.

We are growing on our Non-Retail business. Most products in this segment, new products, new launches, are finished products. They had usually shorter payment terms but this is a very minor effect. I think it's caused mostly because of the reduction of new API suppliers. As inventory levels go back to normal towards the end, these payment terms will extend.

Robert Ford, Bank of America:

Good morning. Congratulations on the results. I am going to repeat a couple of questions, I do not know whether you have addressed them before. Can you elaborate on the improvements of advertising expenses, as well as marketing reductions? And how soon do you believe you are going to stabilize the payment terms? And finally, what should you take into account when you think about the total addressable market when it comes to quality?

Breno Oliveira:

Bob, good morning. As to the marketing expenses, we have been trying to optimize these expenses now for quite some time in recent years because the market has changed in recent years. Back in 2018, we had less than 10% of expenses was in digital media. Last year, it was about 1/3. And for this year, it's about 60% of our media expenses are focused on digital media.

We are trying to become more efficient as far as these expenses are concerned. We can segment our target audience and we can reach those consumers directly. We had an additional group of 6 brands in OTC that did not receive any media investments.

We are now investing exclusively in our digital channels. That's why we have been trying to optimize these expenses. But given the metrics, when we look at how much you can reach, this has been kept constant. This is more efficient expenses. We are spending less per targeted audience reached. The IR department can give you further detailed metrics and how we measure productivity expenses on marketing.

Adalmario Couto:

Bob, let me answer the other two questions. The second question is bringing back the inventory days and has to do with payment terms with suppliers, right?

Robert Ford:

Yes, that's right.

Adalmario Couto:

By year's end, our inventory levels should be very similar to the ideal level. But 1Q25, we expect that inventory levels will be very similar to that of the pandemic levels when we compare that to CGS. About 50%, 60% of our costs is inventory. This is a healthy level, the way we see it unlike the terms we had estimated last year, but mostly because of the slowdown of the market at year's end that was extended more than expected.

But again, it's in line with the strategy of what we expect until the end of this year. This will generate relevant cash flow for the Company for this year as well as for the start of 2025.

As to the launches, we have about 70 new launches for the year. We remain focused on launches in some categories in which we had a reduced market share, continuous use prescription drugs and these are the most relevant markets, the ones that grow the most. And there's a good opportunity to gain market share and become more relevant in these segments. We have many new introductions for this year and for the following years, too.

If you take patents being terminated, the addressable market is over R\$10 billion, molecules that will lose their patents in the next 3 years. And we have a pipeline underway to be the first one in the market, and even bring in incremental innovation to stand out in this market. So we are very focused on these new activities.

Our strategy is also to extend the lines for those power brands and those that will become power brands, innovation, new products, introduction, that's the best way to maintain the life cycle of these brands. So we remain focused on investing on these activities.

We have 3 launches of brands that are already power brands, and that will contribute the performance and the sell-out of those brands. So everything remains on track and we remain very optimistic about the pipeline we have.

Breno Oliveira:

Bob, let me just add to what Adalmario said. There's a huge market value in the following years, about R\$10 billion just like Adalmario said, and we have projects underway to address over 90% of this new market. This may mean to us and to the entire market a very significant growth outside of these patents.

Leandro Bastos, Citi:

Good morning. I have two questions, actually. Can you elaborate on your sales in April, and your growing acute medication growth? Looking at 2023, what are the landmarks quarter-on-quarter? Does it make sense to see some more depressed quarters as the

market evolves and starts using other molecules? Can you comment on this acute medications segment? That's my first question.

Number two, can you talk about the competition with generic drugs? How are you managing that situation? Thank you.

Breno Oliveira:

Leandro, the market is growing substantially in April as expected. We have more working days in April than last April. March had fewer working days and the growth in March was a lot smaller than the average, and now we see a reversal of that movement in April. So high-double and mid-double digits growth. So again, in line with our expectations.

As to the quarterly dynamics, I cannot give you any indication on the acute drugs medication. That will depend on temperature and temperature variations throughout the country.

We know that last year we had the hottest winter in the past 60 years, and it will not happen again this year probably, but it's difficult to predict that dynamics, especially on a quarterly basis. But there are the effects of that basis for comparison, because last year, it was towards the end of the winter that we had higher temperatures, and that should be better this year.

As to the generics, I think we talked about it in the last call. That will vary depending on the molecule and especially because of the higher inventory levels both from us and competitors. We ended up having higher inventory levels given the smaller demand than expected. Some players for some molecules will adopt a more aggressive policy to move that inventory and they are more commercially aggressive. We do not believe it's a long-term trend.

We hear it from investors, from you, questions about greater capacity and what the impact would be for competition. We believe it has to do with the availability of raw materials and finished goods rather than filling that capacity gap.

Most players that are increasing their capacity focus way more on the prescription segment and OTC segment as well, and they struggle, they fight for the marketing media promotions with doctors rather than price because of capacity availability.

Mauricio Cepeda, Morgan Stanley:

Thank you for taking my questions. My question is about channel strategy. You said that sell-out is coming back. Based on Sindusfarma data, January and February were strong months, but there's a mix between sell-in and sell-out in that market research data, and March was a slow month even for generic drugs. Do you believe there's a difference between network or independent drug stores? Neo Química adopted this channel. Is there something specific from the independents that would interfere in the market performance?

My second question piggybacks on Bob's question, portfolio. You had R\$10 billion worth of patents being expired. Once they do expire, are they in non-retail or retail? If they are in retail, would you be able to reposition your portfolio for biologicals and maybe reduce that dependency on generic and similar products?

Breno Oliveira:

Mauricio, let me answer the first question about channels. We have looked at the independence that was somewhat weaker in 4Q, actually the 2H of last year. There are some specific cases, distributors that ran into financial problems but they were very one-off events. But we believe that this has to do with the inventory level and how IQVIA measures that inventory levels. IQVIA measures sell-out at the distributor's sale to independent drug stores. And since demand was smaller than expected, these drugstores ended up buying less to reduce their store levels, impacting 4Q and the entire 2H of last year.

More recently, we do not see that happening. There's a recovery going on from independents. Back in March, they had greater impact because of the working days. Drugstores buy and sell on working days, not on weekends. But this is going back to normal in April. I do not have the data on a per channel basis, but independents are growing even more than those from major chains. We do not see that as a long-term trend. There aren't major changes in the dynamics playing out when we compare different channels in the mid term and long term.

On to patents. These numbers we mentioned are for retail only. There's another amount that's for Non-Retail, and we are also addressing it through the new business unit from our Non-Retail segment. I do not think demand will change dramatically because when these patents expire, there will be generic products as well.

So there's room, the way we see it, to improve our prescription segment. Our goal is to introduce branded products for medical visitation as well as generics once these patents expire. I do not see any major change happening. Especially at the start of that expiration, there is less competition and margins tend to be bigger than when you compare it to a generic that is more commoditized and which you have several players fighting for that segment, especially in semaglutide, which is most of this market, which you have patents being expired.

The way we see it, the development of these new products is not as simple as that of oral and solid drugs and there's more competition there. So competition for this molecule specifically should be smaller and once that patent expires.

Lucca Biasi, UBS:

Good morning. We have two questions. The first one may be a repetition, but if you could please elaborate, giving us more quantitative data, what's your expectation from the growth from generics and prescription and OTC?

And the other one, with a longer-term view, what are the main impacts of the tax reform?

Breno Oliveira:

Lucca, as to the first question, I think the growth capacity, not only prescription actually but also including OTC, we call them brands, the potential is huge. Maybe 2/3 of the pipeline is focused on these 2 business units. And especially for prescription products, chronic medications specifically, that's our long-term strategy, to further diversify our portfolio between acute and chronic medications. So the Company's capacity is huge. So our expectation is to gain market share in this segment.

On to the tax reform, it's still too soon to make comments about possible impacts for the Company. We have been working at it. We have been monitoring very closely since it was announced last Wednesday. But again, it's a bill. It has to be approved in both the House and the Senate. So there may be some changes in the draft proposal.

We have been talking to other companies with business associations to better understand the other players' take and the tax burden for the industry, for the pharmaceutical industry. We do not see any major impacts especially with these preliminary analyses.

We do not foresee any material impact, but we are still looking at the detailed information. It has over 400 pages, we have been talking to external consultants. But at first, we do not detect any increase in the tax burden for the pharmaceutical industry.

Lucca Marquezini, Itaú BBA:

Good morning. Thank you for taking our question. I would like to ask a question about the gross margin. There should be an impact for the rest of the year. Could you elaborate in that sense? Maybe having less exposure to generics and the reduction of OTC in the mix, how can that impact gross margins for the remainder of the year? Thank you.

Adalmario Couto:

Good morning. As to the mix, we expect something smaller than last year because of the Non-Retail channel that is growing more than the rest of the Company's portfolio. As we have said before, this Non-Retail portfolio has smaller gross margins, but when you look as far as the EBITDA margin contribution, it's very similar to other business units, because it needs no promotional effort, a very reduced salesforce.

So the impact is a little smaller than that of 2023, especially because of more growth coming in from the Non-Retail channel.

Samuel Alves, BTG Pactual:

Good morning. Two quick questions. One is about dengue fever. I recall that you said that you are expecting somewhat of a neutral performance for the Company. There are some medications, AAS and other pain killers that end up having a positive effect. So here's my question: what was the result in the quarter? Was it positive? Was it negative? Do you believe that's cooling down in April, more specifically related to dengue fever?

And the second question is about your plant capacity usage. In March, it was somewhat lower. If you could please share some data regarding to plant usage. Thank you.

Breno Oliveira:

Samuel, the dengue fever had a slightly negative impact in the quarter, in 3 categories: AAS, small; ibuprofen, which is bigger, especially with Alivium for children's medications; and corticoids. So these 3 categories had a drop in sales, mostly driven by dengue.

Because when in doubt, there are a few cases when you think about the entire population, many people do not take the test. They have the symptoms. Either the doctor or the patients themselves will look for other equivalent medication. The positive note,

especially in Southeast Brazil, cases are coming down substantially, and we believe that there will not be major impacts in 2Q. That's our expectation.

As to the plant capacity, that will vary depending on the line, the type of technology. On average, our capacity is about 70%. In previous years, we had to resort to a 6 by 2 shifts, which is basically the lines operating 24/7. That has been brought down. Almost every line in the Company is down. Labor costs are lower, therefore, again, on average, 70% capacity, 7-0. So in other words, there's room for growth if necessary, not requiring additional CAPEX expenses.

Our CAPEX expenses are for very specific projects. We internalize Takeda's portfolio production and Sanofi's portfolio as well. We are finishing sterile product line and there's also the P&D, the R&D and oncologic products manufacturing as well as producing raw material for IFA for Buscopan. Again, these are projects we are investing now but looking at returns on further down the road, new activities but not to expand production capacity for current products.

And you talked about capacity for March. There was no reduction in March. It happened earlier this year, just like we had collective vacation. Last year, they were in April, and this year, they were in January. You have less production. Instead of transferring debt expenses in the inventory, you have that variation on a quarterly basis. But overall, there shouldn't be cost impact on average for 2024.

Operator:

This concludes the Q&A session. We will turn it over to Mr. Breno Oliveira for his closing remarks.

Breno Oliveira:

Thank you for attending, for being interested in the Company's results. We remain very excited with the rest of the year, and our IR team is available to answer any questions you may have. Thank you once again.

Operator:

This concludes Hypera Pharma's earnings call. Thank you for attending, and have a wonderful day.

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